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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter VII. GOVERNING LAW

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LEGISLATIVE RECOMMENDATIONS

1. The law governing the project agreement (see paras. 4 and 5)

1. The host country may wish to enact provisions that indicate, as appropriate, the statutory or regulatory texts that govern the project agreement and those whose application is excluded.

2. The law governing contracts entered into by the concessionaire (see paras. 6-8)

2. The host country may wish to consider adopting legislative provisions recognizing the freedom of the concessionaire and its lenders, insurers and other contracting partners to choose the applicable law to govern their contractual relations.

3. Other relevant areas of legislation (see paras. 9-58)

3. The host country may wish to consider reviewing and, as appropriate, revising rules of law in other areas relevant to privately financed infrastructure projects (investment promotion and protection, property law, rules and procedures on expropriation, intellectual property law, security interests, company law, accounting practices, contract law, rules on government contracts and administrative law, insolvency law, tax law, environmental and consumer protection law and anti-corruption measures).

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. General remarks

1. The stage of development of the relevant laws of the host country, the stability of its legal system and the adequacy of remedies available to private parties are essential elements of the overall legal framework for privately financed infrastructure projects. By reviewing and, as appropriate, improving its laws in those areas of immediate relevance for privately financed infrastructure projects, the host country will make an important contribution to securing a hospitable climate for private sector investment in infrastructure. Greater legal certainty and a favourable legal framework will translate into a better assessment of country risks by lenders and project sponsors. This will have a positive influence on the cost of mobilizing private capital and reduce the need for governmental support or guarantees (see chap. II, "Government support", ___).

2. Section B deals with choice of the law or laws governing the project agreement and other contracts entered into by the concessionaire during the life of the project (see paras. 3-8). Section C points out a few selected aspects of the laws of the host country that, without necessarily dealing directly with privately financed infrastructure projects, may have an impact on their implementation (see paras. 9-58). Section D indicates the possible relevance of a few international agreements for the implementation of privately financed infrastructure projects in the host country (see paras. 59-63).

B. The law governing the project agreement and related contracts

3. Statutory provisions governing the project agreement are not frequently found in domestic legislation on privately financed infrastructure projects. Where they do appear, they usually provide for the application of the laws of the host country by a general reference to domestic law or by mentioning special statutory or regulatory texts that apply to the project agreement. In some legal systems there may be an implied submission to the laws of the host country, even in the absence of a statutory provision to that effect. Statutory provisions concerning the law governing contracts entered into by the concessionaire appear even more rarely in domestic legislation, as discussed below.

1. The law governing the project agreement

4. The law governing the project agreement would typically include the rules contained in laws and regulations of the host country related directly to privately financed infrastructure projects, where specific legislation on the matter exists. The main elements of those laws have been considered in previous chapters of the *Guide*. As noted earlier (see chap. I, "General legislative considerations", ___), in some countries the project agreement may be subject to administrative law, while in others the project agreement may be governed by private law (see also paras. 38-41). The governing law would also include legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see paras. 9-58). Some of those rules may be of an administrative or other public law nature and their application in the host country may be mandatory, such as environmental protection measures and health and labour conditions. Some domestic laws expressly identify the matters that are subject to rules of mandatory application. However, a number of issues arising out of the project agreement or the operation of the facility may not be the subject of mandatory rules of a public law nature. This is typically the case of most contractual issues arising under the project agreement (e.g. formation, validity and breach of contract, including liability and compensation for breach of contract and wrongful termination).

5. Even though it would not be possible to list exhaustively in the law all the statutes or regulations of direct or subsidiary relevance for privately financed infrastructure projects, for purposes of clarity it may be advisable

to indicate in the law those statutory and regulatory texts which are directly applicable to the execution of privately financed infrastructure projects and, as appropriate, those whose application is excluded.

2. The law governing contracts entered into by the concessionaire

6. It is common for the concessionaire and its contractors to choose a law that is familiar to them and that in their view adequately governs the issues addressed in their contracts. Depending upon the type of contract, different issues concerning the governing-law clause will arise. For example, as regards the financing agreements that the concessionaire enters into, it is most likely that the lenders will require that the governing law be that of a jurisdiction with an established set of laws regarding international financial transactions. Equipment supply and other contracts may be entered into with foreign companies and the parties may wish to choose a law known to them as providing, for example, an adequate warranty regime for equipment failure or non-conformity of equipment. In turn, the concessionaire may agree to the application of the laws of the host country in connection with contracts entered into with local customers.

7. Domestic laws seldom contain provisions concerning the law governing the contracts entered into by the concessionaire. In a few countries, the law limits the application of foreign law to issues that are not regulated by domestic law or subjects choices of foreign law to approval by the contracting authority. However, most countries have found no compelling reason for making provisions concerning the law governing the contracts between the concessionaire and its contractors and have preferred to leave the question to a choice-of-law clause in their contracts or to the applicable conflict-of-laws rules.

8. In some cases, provisions have been included in domestic legislation for the purpose of clarifying, as appropriate, that the contracts entered into between the concessionaire and its contractors are governed by private law and that the contractors are not agents of the contracting authority. A provision of that type may in some countries have a number of practical consequences, such as no subsidiary liability of the contracting authority for the acts of the subcontractors or no obligation on the part of the responsible public entity to pay worker's compensation for work-related illness, injury or death to the subcontractors' employees.

C. Other relevant areas of legislation

9. In addition to issues pertaining to legislation directed specifically towards privately financed infrastructure projects, a favourable legal framework also requires supportive provisions in other areas of legislation. Private investment in infrastructure will be encouraged by the existence of legislation that promotes and protects private investment in economic activities. The following paragraphs pinpoint only a few selected aspects of other fields of law that may have an impact on the implementation of infrastructure projects. The existence of adequate legal provisions in those other fields may facilitate a number of transactions necessary to carrying out infrastructure projects and help to reduce the perceived legal risk of investment in the host country.

1. Promotion and protection of investment

10. One matter of particular concern for the project consortia and the lenders is the degree of protection afforded to investment in the host country. The confidence of investors in the host country may be fostered, for example, by protection from nationalization or dispossession without judicial review and appropriate compensation in accordance with international law. Project sponsors participating in project consortia will also be concerned about their ability, *inter alia*, to bring to the country without unreasonable restriction the qualified personnel required to work with the project, to import needed goods and equipment, to have access to foreign exchange as needed and to transfer abroad or repatriate their profits or sums needed to repay loans that the company has entered into for the purpose of the infrastructure project. In addition to specific guarantees that may be provided by the Government (see chap. II, "Government support", ___), legislation on promotion and

protection of investment may play an important role in connection with privately financed infrastructure projects. For countries that already have adequate investment protection legislation, it may be useful to consider expressly extending the protection provided in such legislation to private investment in infrastructure projects.

11. An increasing number of countries have entered into bilateral investment agreements that aim at facilitating and protecting the flow of investment between the contracting parties. Investment protection agreements usually contain provisions concerning the admission and treatment of foreign investment; transfer of capital between the contracting parties (e.g. payment of dividends abroad or repatriation of investment); availability of foreign exchange for transfer or repatriation of proceeds of investment; protection from expropriation and nationalization; and settlement of investment disputes. The existence of such an agreement between the host country and the originating country or countries of the project sponsors may play an important role in their decision to invest in the host country. Depending on its terms, such an agreement may reduce the need for assurances or guarantees by the Government geared to individual infrastructure projects.

2. Property law

12. It is desirable for the property laws of the host country to reflect acceptable modern standards, contain adequate provisions on the ownership and use of land and buildings, as well as movable and intangible property, and ensure the concessionaire's ability to purchase, sell, transfer and license the use of property, as appropriate. Constitutional provisions protecting property rights have been found to be important factors to foster private investment in many countries (see also chap. I, "General legislative considerations", ___).

13. Where the concessionaire owns the land on which the facility is built, it is important that the ownership of the land can be clearly and unequivocally established through adequate registration and publicity procedures. The concessionaire and lenders will need clear proof that ownership of the land will not be subject to dispute. They will therefore be reluctant to commit funds to the project if the laws of the host country do not provide adequate means for ascertaining ownership of the land.

14. It is also necessary to provide effective mechanisms for the enforcement of the property and possessory rights granted to the concessionaire against violation by third parties. Enforcement should also extend to easements and rights of way that may be needed by the concessionaire for providing and maintaining the relevant service (e.g. placing of poles and cables on private property to ensure the distribution of electricity) (see chap. IV, "The project agreement", ___).

3. Rules and procedures on expropriation

15. Where the host Government assumes responsibility for providing the land required for the implementation of the project, it may be either purchased from its owners or, if necessary, compulsorily acquired against the payment of adequate compensation by procedures referred to in the *Guide* as "expropriation" (see chap. IV, "The project agreement", ___). Many countries have legislation governing expropriation procedures and that legislation would probably apply to the compulsory acquisition of property required for privately financed infrastructure projects.

16. Expropriation proceedings often involve both administrative and judicial phases, which may be lengthy and complex. The host Government might thus wish to review existing provisions on expropriation for reasons of public interest with a view to assessing their adequacy to the needs of large infrastructure projects and to determining whether such provisions allow quick and cost-effective procedures, with due consideration of the rights of the owners. It is particularly important to enable the host Government to take possession of the property as early as possible, to the extent permitted by law, so as to avoid start-up delay and increased project costs

4. Intellectual property law

17. Privately financed infrastructure projects frequently involve the use of new or advanced technologies protected under patents or similar intellectual property rights. They may also involve the formulation and submission of original or innovative solutions, which may constitute the proponent's proprietary information under copyright protection. Therefore, private investors, national and foreign, bringing new or advanced technology into the host country or developing original solutions will need to be assured that their intellectual property rights will be protected and that they will be able to enforce those rights against infringements.

18. A legal framework for the protection of intellectual property may be provided by adherence to international agreements regarding the protection and registration of intellectual property rights. It would be desirable to strengthen the protection of intellectual property rights in line with such instruments as the Paris Convention for the Protection of Industrial Property of 1883.[1] The Convention applies to industrial property in the widest sense, including inventions, marks, industrial designs, utility models, trade names, geographical indications and the repression of unfair competition. The Convention provides that, as regards the protection of industrial property, each contracting State must grant national treatment. It also provides for the right of priority in the case of patents, marks and industrial designs and establishes a few common rules that all the contracting States must follow in relation to patents, marks, industrial designs, trade names, indications of source, unfair competition and national administrations. A framework for further international patent protection is provided under the Patent Cooperation Treaty of 1970, which makes it possible to seek patent protection for an invention simultaneously in each of a large number of countries by filing an international patent application.

19. Other important instruments providing international protection of industrial property rights are the Madrid Agreement Concerning the International Registration of Marks of 1891,[2] the Protocol Relating to the Madrid Agreement of 1989 and the Common Regulations under the Madrid Agreement and the Protocol Relating thereto of 1998. The Madrid Agreement provides for the international registration of marks (both trademarks and service marks) at the International Bureau of the World Intellectual Property Organization (WIPO). International registration of marks under the Madrid Agreement has effect in several countries, potentially in all the contracting States (except the country of origin). Furthermore, the Trademark Law Treaty of 1994 simplifies and harmonizes procedures for the application for registration of trademarks, changes after registration and renewal.

20. In the area of industrial designs, the Hague Agreement Concerning the International Deposit of Industrial Designs of 1925[3] provides for the international deposit of industrial designs at the International Bureau of WIPO. The international deposit has, in each of the contracting States designated by the applicant, the same effect as if all the formalities required by the domestic law for the grant of protection had been complied with by the applicant and as if all administrative acts required to that end had been accomplished by the office of that country.

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[1] As revised at Brussels on 14 December 1900, at Washington, D.C., on 2 June 1911, at The Hague on 6 November 1925, at London on 2 June 1934, at Lisbon on 31 October 1958 and at Stockholm on 14 July 1967 and as amended on 2 October 1979.

[2] As revised at Brussels on 14 December 1900, at Washington, D.C., on 2 June 1911, at The Hague on 6 November 1925, at London on 2 June 1934, at Nice on 15 June 1957 and at Stockholm on 14 July 1967.

[3] With the Additional Act of Monaco of 1961, the Complementary Act of Stockholm of 1967 as amended on 28 September 1979 and the Regulations Under the Hague Agreement Concerning the International Deposit of Industrial Designs of 1998.

21. The above instruments are complemented by treaties establishing international classifications, such as the Strasbourg Agreement Concerning the International Patent Classification of 1971, the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks of 1957, the Vienna Agreement Establishing an International Classification of the Figurative Elements of Marks of 1973 and the Locarno Agreement Establishing an International Classification for Industrial Designs of 1968.

5. Security interests

22. Crucial to the success of privately financed infrastructure projects is a domestic legal regime that offers lenders reliable security. The types of asset that might be encumbered and the types of security interest that might be created will vary from one system of law to the next. Because of the significant differences between legal systems regarding the law of security interests, the *Guide* does not discuss in detail the technicalities of the requisite legislation and the following paragraphs provide only a general outline of the main elements of a modern regime for secured transactions.

23. In some legal systems, security interests can be created in virtually all kinds of assets, including intellectual property, whereas in other systems security interests can only be created in a limited category of assets, such as land and buildings. In some countries, security interests can be created over assets that do not yet exist (future assets) and security may be taken over all of a company's assets, while allowing the company to continue to deal with those assets in the ordinary course of business. Some legal systems provide for a non-possessory security interest, so that security can be taken over assets without taking actual possession of the assets; in other systems, as regards those assets which are not subject to a title registration system, security may only be taken by physical possession or constructive possession. Under some systems, enforcement of the security interest can be undertaken without court involvement, whereas in other systems it may only be enforced through court procedures. Some countries provide enforcement remedies that not only include sale of the asset, but also enable the secured lender to operate the asset either by taking possession or appointing a receiver; in other countries, judicial sale may be the primary enforcement mechanism. Under some systems, certain types of security will rank ahead of preferential creditors, whereas in others the preferential creditors rank ahead of all types of security. In some countries, creation of a security interest is cost-efficient, with minimal fees and duties payable, whereas in other countries it can be costly. In some countries, the value of the amount of security taken may be unlimited, while in others the value of security cannot be excessive in comparison with the debt owed. Some legal systems impose obligations on the secured lender to the debtor and to third parties on enforcement of the security, such as the obligation to sell the asset at fair market value.

24. The type and extent of security offered by the concessionaire or its shareholders will play a central role in the contractual arrangements for the financing of infrastructure projects. The security arrangements may be complex and consist of a variety of forms of security, including fixed security over physical assets of the concessionaire (e.g. mortgages or charges), pledges of shares of the concessionaire and assignment of intangible assets (receivables) of the project. While the loan agreements are usually subject to the governing law chosen by the parties, the laws of the host country will in most cases determine the type of security that can be enforced against assets located in the host country and the remedies available. Differences in the type of security or limitations in the remedies available under the laws of the host country may be a cause of concern to potential lenders. It is therefore important to ensure that domestic laws provide adequate legal protection to secured creditors and do not hinder the ability of the parties to establish appropriate security arrangements.

25. Basic legal protection may include provisions ensuring that fixed security (e.g. a mortgage) is a registrable interest and that, once such security is registered in the central register of title or other public register, any purchaser of the property to which the security attaches should take the property subject to such security. This may be difficult, since in many countries no central registers of title exist. Furthermore, security should be enforceable against third parties, have the nature of a property right and not a mere obligation, and should entitle the person receiving security to a sale, in enforcement proceedings, of the assets taken as security. Secured creditors should enjoy preference to unsecured creditors in insolvency proceedings.

26. Another important aspect concerns the flexibility given to the parties to define the assets that are given as security. In some legal systems, broad freedom is given to the parties in the definition of assets that may be given as security. In some legal systems, it is possible to create security that covers all the assets of an enterprise, making it possible to sell the enterprise as a going concern, which may enable an enterprise in financial difficulties to be rescued while increasing the recovery of the secured creditor. Other legal systems, however, allow only the creation of security that attaches to specific assets and do not recognize security covering the entirety of the debtor's assets. There may also be limitations on the debtor's ability to trade in goods given as security. The existence of limitations and restrictions of this type makes it difficult or even impossible for the debtor to create security over generically described assets or over assets traded in the ordinary course of its business.

27. Given the long-term nature of privately financed infrastructure projects, the parties may wish to be able to define the assets that are given as security specifically or generally. They may also wish such security to cover present or future assets and assets that might change during the life of the security. It may be desirable to review existing provisions on security interests with a view to including provisions enabling the parties to agree on suitable security arrangements.

28. As indicated earlier (see chap. IV, "The project agreement", ___), another form of security typically given in connection with certain privately financed infrastructure projects is an assignment to lenders of proceeds from contracts with customers of the concessionaire. Those proceeds may consist of the proceeds of a single contract (e.g. a power purchase commitment by a power distribution entity) or of a large number of individual transactions (e.g. monthly payment of gas or water bills). In most cases it would not be practical for the concessionaire to specify individually the receivables being assigned to the creditors. Therefore, assignment of receivables in project finance typically takes the form of a bulk assignment of future receivables. However, there may be considerable uncertainty in various legal systems with regard to the validity of the wholesale assignment of receivables and of future receivables.

29. Thus far, no comprehensive uniform regime or model for the development of domestic security laws has been developed by international intergovernmental bodies. Governments would be advised, however, to take account of various efforts being undertaken in different organizations.

30. A model for the development of modern legislation on security interests is offered in the Model Law on Secured Transactions, which was prepared by the European Bank for Reconstruction and Development (EBRD) to assist legislative reform efforts in central and eastern European countries. Besides general provisions on who can create and who can receive a security right and general rules concerning the secured debts and the charged property, the EBRD Model Law on Secured Transactions covers other matters, such as the creation of security rights, the interests of third parties, enforcement of security and registration proceedings. The solutions proposed in the EBRD Model Law are intended to achieve the objectives discussed in paragraphs 24-29 above.

[*Note for the Commission. Appropriate reference will be made to the draft convention on assignment in receivables financing presently being developed by the Working Group on International Contract Practices, as well as to other international initiatives (e.g. the draft model inter-American law on secured transactions currently being considered by the Organization of American States in the context of preparations for the Sixth Inter-American Conference on Private International Law and the UNIDROIT draft convention on international interests in mobile equipment.*]

6. Company law

31. In most projects involving the development of a new infrastructure, the project sponsors will establish the project entity as a separate legal entity in the host country (see chap. IV, "The project agreement", ___). It is recognized that the project entity may take various forms in different countries, which may not necessarily entail a corporation. As in most cases it is a corporate form that is selected, it is particularly important for the host country to have adequate company laws with modern provisions on essential matters such as establishment procedures, corporate governance, issuance of shares and their sale or transfer, accounting and financial statements and protection of minority shareholders. Furthermore, the recognition of the investors' ability to establish separate entities to serve as special-purpose vehicles for raising financing and disbursing funds may facilitate the closing of project finance transactions (see chap. IV, "The project agreement", ___).

32. Although various corporate forms may be used for incorporating project operators, a common characteristic is that the concessionaire's owners (or shareholders) will require that their liability be limited to the value of their shares in the company's capital. If it is intended that the concessionaire will offer shares to the public, limited liability will be necessary, as the prospective investors will usually only purchase those shares for their investment value and will not be closely involved in the operation of the concessionaire. It is therefore important that the laws of the host country provide adequately for the limitation of liability of shareholders. Furthermore, adequate provisions governing the issuance of bonds, debentures or other securities by commercial companies will enable the concessionaire to obtain funds from investors on the security market, thus facilitating the financing of certain infrastructure projects.

33. Legislation should establish the responsibilities of directors and administrators of the concessionaire, including the basis for criminal responsibility. It can also set out provisions for the protection of third parties affected by any breach of corporate responsibility. Modern company laws often contain specific provisions regulating the conduct of managers so as to prevent conflicts of interest. Provisions of this type require that managers act in good faith in the best interest of the company and do not use their position to foster their own or any other person's financial interests to the detriment of the company. Provisions intended to curb conflicts of interest in corporate management may be particularly relevant in connection with infrastructure projects, where the concessionaire may wish to engage its own shareholders, at some stage of the project, to perform work or provide services in connection with it (see chap. V, "Infrastructure development and operation", ___).

34. It is important for the law to regulate adequately the decision-making process both for meetings of the shareholders and meetings of management organs of the company (e.g. the board of directors or supervisory board). Protection of shareholders' rights and, in particular, protection for minority shareholders from abuse by controlling or majority shareholders are important elements of modern company laws. Mechanisms for the settlement of disputes among shareholders are also critical. It is useful to recognize the right of the shareholders to regulate a number of additional matters concerning the management of the concessionaire through agreements among themselves or through management contracts with the directors of the concessionaire.

7. Accounting practices

35. In several countries, companies are required by law to follow generally accepted accounting practices. Among the reasons for this is that the adoption of standard accounting practices is a measure taken in many countries to achieve uniformity in the valuation of businesses. The use of modern and internationally acceptable accounting practices may be instrumental in ensuring the marketability of bonds and other security issued by the concessionaire for the purpose of raising funds in international financial markets. In connection with the selection of the concessionaire, the use of standard accounting practices may also facilitate the task of evaluating the financial standing of bidders in order to determine whether they meet the pre-selection criteria required by the contracting authority (see chap. III, "Selection of the concessionaire", ___). Standard accounting practices are also essential for carrying out audits of the profits of companies, which may be required for the application of tariff structures and the verification of compliance by the regulatory body (see chap. V, "Infrastructure development and operation", ___).

8. Contract law

36. The contract laws of the host country play an important role in connection with contracts entered into by the concessionaire with subcontractors, suppliers and other parties. The domestic law on commercial contracts should provide adequate solutions to the needs of the concessionaire and its contracting parties, including flexibility in devising the contracts needed for the construction and operation of the infrastructure facility. Apart from some essential elements of adequate contract law, such as general recognition of party autonomy, judicial enforceability of contract obligations and adequate remedies for breach of contract, the laws of the host country may create a favourable environment for privately financed infrastructure projects by facilitating contractual arrangements likely to be used in those projects. An adequate set of rules of private international law is also important, given the likelihood that contracts entered into by the concessionaire will include some international element.

37. Where new infrastructure is to be built, the concessionaire may need to import large quantities of supplies and equipment. Greater legal certainty for such transactions will be ensured if the laws of the host country contain provisions specially adapted to international sales contracts. A particularly suitable legal framework may be provided by adherence to the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)[4] or other international instruments dealing with specific contracts, such as the UNIDROIT Convention on International Financial Leasing (Ottawa, 1988),[5] drawn up by the International Institute for the Unification of Private Law (UNIDROIT).

9. Rules on government contracts and administrative law

38. In many legal systems belonging to or influenced by the tradition of civil law, the provision of public services may be governed by a body of law known as "administrative law", which regulates a wide range of governmental functions. Such systems operate under the principle that the Government can exercise its powers and functions either by means of an administrative act or an administrative contract. It is also generally understood that, alternatively, the Government may enter into a private contract, subject to the law governing private commercial contracts. The differences between the two types of contract may be significant.

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[4] *Official Records of the United Nations Conference on Contracts for the International Sale of Goods, Vienna, 10 March-1 April 1980* (United Nations publication, Sales No. E.82.V.5), part I.

[5] *Acts and Proceedings of the Diplomatic Conference for the adoption of the draft Unidroit Conventions on International Factoring and International Financial Leasing, Ottawa, 9-28 May 1988*, vol. I.

39. Under the concept of the administrative contract, the freedom and autonomy the parties to a private contract enjoy are subordinate to the public interest. In some legal systems, the Government has the right to terminate administrative contracts (see chap. VI, "End of project term, extension and termination", ___) or to modify their scope and terms, for reasons of public interest, usually subject to compensation for loss sustained by the private contracting party (see chap. V, "Infrastructure development and operation", ___). Additional rights might include extensive monitoring and inspection rights, as well as the right to impose sanctions on the private operator for failure to perform. This is often balanced by the requirement that other changes may be made to the contract as may be necessary to restore the original financial equilibrium between the parties and to preserve the contract's general value for the private contracting party (see chap. V, "Infrastructure development and operation", ___). In some legal systems, disputes arising out of government contracts are subject to the exclusive jurisdiction of special tribunals dealing solely with administrative matters, which in some countries are separate from the judicial system (see chap. VIII, "Settlement of disputes", ___).

40. The existence of a special legal regime applicable to infrastructure operators and public service providers is not limited to the legal systems referred to above. Although in other legal systems influenced by the tradition of common law no such categorical distinction is made between administrative contracts and private contracts, similar consequences may be achieved by different means. While under such systems of law it is frequently held that the rule of law is best maintained by subjecting the Government to ordinary private law, it is generally recognized that the administration cannot by contract fetter the exercise of its sovereign functions. It cannot hamper its future executive authority in the performance of those governmental functions which affect the public interest. Under the doctrine of sovereign acts, which is upheld in some common law jurisdictions, the Government as contractor is excused from the performance of its contracts if the Government as sovereign enacts laws, regulations or orders in the public interest that prevent that performance. Thus, the law may permit a government agency to interfere with vested contractual rights. Usually such action is limited so that the changes cannot be of such magnitude that the other party could not fairly adapt to them. In those circumstances, the private party is ordinarily entitled to some sort of compensation or equitable adjustment (see chap. V, "Infrastructure development and operation", ___). In anticipation of such possibilities, in some countries a standard "changes" clause is included in a governmental contract that enables the Government to alter the terms on a unilateral basis or that provides for changes as a result of an intervening sovereign act.

41. Special prerogatives for governmental agencies are justified in those legal systems by reasons of public interest. It is however recognized that special governmental prerogatives, in particular the power to alter the terms of contracts unilaterally, may, if improperly used, adversely affect the vested rights of government contractors. For this reason, countries with a well established tradition of private participation in infrastructure projects have developed a series of control mechanisms and remedies to protect government contractors against arbitrary or improper acts by government agencies, such as access to impartial dispute settlement bodies and full compensation schemes for governmental wrongdoing. Where protection of this nature is not afforded, rules of law providing government agencies with special prerogatives may be regarded by potential investors as an imponderable risk, which may discourage them from investing in particular jurisdictions. For this reason, some countries have reviewed their legislation on government contracts so as to provide the degree of protection needed to foster private investment and remove those provisions which gave rise to concern about the long-term contractual stability required for infrastructure projects.

10. Insolvency law

42. The insolvency of an infrastructure operator or public service provider raises a number of issues that have led some countries to establish special rules to deal with such situations, including rules that enable the host Government to take the measures required to ensure the continuity of the project (see chap. VI, "End of project term, extension and termination", ___). The continuity in the provision of the service may be achieved by means of a legal framework that allows for the rescue of economically viable enterprises facing financial difficulties,

such as reorganization and similar proceedings. In the event that bankruptcy proceedings become inevitable, the secured lenders will be specially concerned about provisions concerning secured claims, in particular as to whether secured creditors may foreclose on the security despite the opening of bankruptcy proceedings, whether secured creditors are given priority for payments made with the proceeds of the security and how claims of secured creditors are ranked. As noted earlier, a substantial portion of the concessionaire's debt takes the form of "senior" loans, with the lenders requiring precedence of payment over payment of the subordinated debt of the concessionaire (see "Introduction and background information on privately financed infrastructure projects", ___). The extent to which the lenders will be able to enforce such subordination arrangements will depend on the rules and provisions of the laws of the country that govern the ranking of creditors in insolvency proceedings. The legal recognition of party autonomy on the establishment of contractual subordination of different classes of loans may facilitate the financing of infrastructure projects.

43. Among the issues that the legislation should address are the following: the question of the ranking of creditors; the priority between the insolvency administrator and creditors; legal mechanisms for reorganization of the insolvent debtor; special rules designed to ensure the continuity of the public service in case of insolvency of the concessionaire; and provisions on avoidance of transactions entered into by the debtor shortly before the opening of the insolvency proceedings.

44. The insolvency of a concessionaire is likely to involve creditors from more than one country or affect assets located in more than one country. It may therefore be desirable for the host country to have provisions in place that facilitate judicial cooperation, court access for foreign insolvency administrators and recognition of foreign insolvency proceedings. A suitable model that may be used by countries wishing to adopt legislation for that purpose is provided in the UNCITRAL Model Law on Cross-Border Insolvency.

11. Tax law

45. In addition to possible tax incentives that may be generally available in the host country or that may be specially granted to privately financed infrastructure projects (see chap. II, "Government support", ___), the general taxation regime of the host country plays a significant role in the investment decisions of private companies. Beyond an assessment of the impact of taxation in the project cost and the expected margin of profit, private investors consider questions such as the overall transparency of the domestic taxation system, the degree of discretion exercised by taxation authorities, the clarity of guidelines and instructions issued to taxpayers and the objectivity of criteria used to calculate tax liabilities. This may be a complex matter, in particular in those countries where the authority to establish or increase taxes or to enforce tax legislation has been decentralized.

46. The stability of the tax regime is crucial to the success of privately financed infrastructure projects. Many projects are highly leveraged and require a predictable cash flow. Unanticipated changes in the taxes that reduce that cash flow can have serious consequences for the project. All potential tax implications should be readily assessable throughout the life of the project. In some countries, the Government is authorized to enter into agreements with the investors for the purpose of guaranteeing the stability of the tax regime applicable to the project. However, the Government may be restrained, by constitutional law or for political reasons, from providing this type of guarantee, in which case the parties may agree on compensation or contractual revision mechanisms for dealing with cost increases due to tax changes (see also chap. V, "Infrastructure development and operation", ___).

47. Most national tax regimes fall into one of three general categories. One approach is worldwide taxation with credits, in which all income earned anywhere is taxed in the home country and double taxation is avoided through the use of a foreign tax credit system; home country taxes are reduced by the amount of foreign taxes already paid. If this approach is used by an investor's home country, the investor's tax liability can be no less than it would be at home. Under a different taxation approach, the foreign income that has already been subject

to foreign tax is exempt from taxation by the home country of the investor. Under a territorial approach, foreign income is exempt from home country taxation altogether. Investors in home countries that use the latter two systems of taxation would benefit from tax holidays and lower tax rates in the host country, but such tax relief would offer no incentive to an investor located in a tax haven.

48. The parties involved in the project may have different concerns over potential tax liability. Investors are usually concerned over the taxation of profits earned in the host country, taxation on payments made to contractors, suppliers, investors and lenders, and tax treatment of any capital gains (or losses) when the concessionaire is wound up. Investors may find that payments used to reduce taxes under their home country regime (such as payments for interest on borrowed funds, investigation costs, bidding costs and foreign exchange losses) may not be available in the host country, or vice versa. Since foreign tax credits are only allowed for foreign income taxes, investors need to ensure that any income tax paid in the host country satisfies the definition of income tax of their own country's taxing authority. Similarly, the concessionaire in the host country may be treated for tax purposes as a different type of entity in the home country. In projects where the assets become the property of the Government, this may preclude deductions for depreciation under the laws of the home country.

49. One particular problem of privately financed infrastructure projects involving foreign investment is the possibility that foreign companies participating in a project consortium may be exposed to double taxation, that is, taxation of profits, royalties and interests in their own home countries as well as in the host country. The timing of tax payments and requirements to pay withholding taxes can also pose problems. A number of countries have entered into bilateral agreements to eliminate or at least reduce the negative effects of double taxation and the existence of such agreements between the host country and the home countries of the project sponsors often plays a role in their tax considerations.

50. Ultimately, it is the cumulative effect of all taxes combined that needs to be taken into consideration. For example, there may be taxes imposed by more than one level of taxing authority; in addition to taxation by the national Government, the concessionaire may also face municipal or provincial taxes. There may also be certain levies other than income taxes, which are often are due and payable before the concessionaire has earned any revenues. These include sales taxes, sometimes referred to as "turnover taxes", value-added taxes, property taxes, stamp duties and import duties. Sometimes special provisions can be made to offer relief from these payments as well.

12. Environmental protection

51. Environmental protection encompasses a wide variety of issues, ranging from handling of wastes and hazardous substances to relocation of persons displaced by large land-use projects. It is widely recognized that environmental protection is a critical prerequisite to sustainable development. Adhering to treaties relating to the protection of the environment may help to strengthen the international regime of environmental protection. A large number of international instruments have been developed in the past decades to establish common international standards. These include the following: Agenda 21 and the Rio Declaration on Environment and Development, adopted by the United Nations Conference on Environment and Development in 1992; the World Charter for Nature (General Assembly resolution 37/7 of 28 October 1982); the Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal of 1989; the Convention on Environmental Impact Assessment in a Transboundary Context of 1991; and the Convention on the Protection and Use of Transboundary Watercourses and International Lakes of 1992.

52. Environmental protection legislation is likely to have a direct impact on the implementation of infrastructure projects at various levels and environmental matters are among the most frequent causes of disputes. Environmental protection laws may include various requirements, such as the consent by various

environmental authorities, evidence of no outstanding environmental liability, assurances that environmental standards will be maintained, commitments to remedy environmental damage and notification requirements. These laws often require prior authorization for the exercise of a number of business activities, which may be particularly stringent for some types of infrastructure (e.g. waste water treatment, waste collection, the coal-fired power sector, power transmission, roads and railways). Authorizations and licences are often required for undertaking construction work or for installing certain physical structures. The denial of an environmental licence may constitute an unsurmountable obstacle to the execution of the whole project.

53. It is therefore advisable to ensure the highest possible degree of clarity in provisions concerning the tests that may be applied by the environmental authorities, the documentary and other requirements to be met by the applicants, the conditions under which licences are to be issued and the circumstances that justify the denial or withdrawal of a licence. Particularly important are provisions that guarantee the applicant's access to expeditious appeals procedures and judicial recourse, as appropriate. It may also be advisable to ascertain to the extent possible, prior to the final award of the project, whether the conditions for obtaining such a licence are met. In some countries, special government agencies or advocacy groups may have the right to institute legal proceedings to seek to prevent environmental damage, which may include the right to seek the withdrawal of a licence deemed to be inconsistent with applicable environmental standards. In some of those countries, it has been found useful to involve representatives of the public in the proceedings that lead to the issuance of environmental licences. The legislation may also establish the range of penalties that may be imposed and specify the parties that may be held responsible for the damage.

54. Further issues under the host country's environmental laws may arise when the concessionaire takes over an existing infrastructure facility, in particular where the question of responsibility for environmental damage caused by government-owned industry prior to privatization has not been clarified. Private investors may be reluctant to take over an existing infrastructure or purchase shares in public utilities that may be called upon in the future to compensate for or remedy environmental damage caused by the enterprise before it was privatized. It may therefore be advisable to establish mechanisms for compensating the private investors for liability incurred as a result of environmental damage caused during the period of government operation.

13. Consumer protection laws

55. A number of countries have special rules of law on consumer protection. Consumer protection laws vary greatly from country to country, both in the way they are organized and in their substance. Nevertheless, consumer protection laws often include provisions such as favourable time limits for asserting claims and enforcing contractual rights; special rules for the interpretation of contracts whose terms are not usually negotiated with the consumer (sometimes referred to as "adhesion contracts"); extended warranties in favour of consumers; special termination rights; access to simplified dispute settlement instances; or other protective measures. From the concessionaire's perspective, it is important to consider whether the host country's laws on consumer protection may limit or hinder the concessionaire's ability to enforce, for instance, its right to obtain payment for the services provided, to adjust prices or to discontinue services to customers who fail to pay for the services.

14. Anti-corruption measures

56. The investment and business environment in the host country may also be enhanced by measures to fight corruption in the administration of government contracts. The rules covering the functioning of contracting authorities and the monitoring of public contracts should be reviewed and, where such rules do not exist, appropriate legislation and regulations should be developed and adopted to ensure the required degree of transparency and integrity. Simplicity and consistency, coupled with the elimination of unnecessary procedures

that prolong the administrative procedures or make them cumbersome, are additional elements to be taken into consideration in this context.

57. It is furthermore particularly important for the host country to take effective and concrete action to combat all forms of corruption, bribery and related illicit practices, in particular to pursue effective enforcement of existing laws prohibiting bribery.

58. The enactment of laws that incorporate international agreements and standards on integrity in the conduct of public business may represent a significant step in that direction. Important standards are contained in two resolutions of the United Nations General Assembly: resolution 51/59 of 12 December 1996, by which the Assembly adopted the International Code of Conduct for Public Officials, and resolution 51/191 of 16 December 1996, by which it adopted the United Nations Declaration against Corruption and Bribery in International Commercial Transactions. Other important instruments include the Inter-American Convention against Corruption, adopted by the Organization of American States at the Specialized Conference for Consideration of the Draft Inter-American Convention against Corruption, held in Caracas in 1996, and the Convention on Combating Bribery of Foreign Public Officials in International Business Transaction of 1997, which was negotiated under the auspices of the Organisation for Economic Cooperation and Development.

D. International agreements

59. In addition to the internal legislation of the host country, privately financed infrastructure projects may be affected by international agreements entered into by the host country. The implications of certain international agreements is discussed briefly below.

1. Membership in multilateral financial institutions

60. Membership in multilateral financial institutions such as the World Bank, the International Development Association, the International Finance Corporation, the Multilateral Investment Guarantee Agency and the regional development banks may have a direct impact on privately financed infrastructure projects in various ways. Firstly, the host country's membership in those institutions is typically a requirement in order for projects in the host country to receive financing and guarantees provided by those institutions. Secondly, the rules on financing and guarantee instruments provided by those institutions typically contain a variety of terms and conditions of direct relevance for the terms of the project agreement and the loan agreements negotiated by the concessionaire (e.g. clause of negative pledge of public assets and provision of counter-guarantees in favour of the multilateral financial institution). Lastly, multilateral financial institutions usually follow a number of policy objectives whose implementation they seek to ensure in connection with projects supported by them (e.g. adherence to internationally acceptable environmental standards; long-term sustainability of the project beyond the initial concession period; transparency and integrity in the selection of the concessionaire and the disbursement of their loans).

2. General agreements on trade facilitation and promotion

61. A number of multilateral agreements have been negotiated to promote free trade at the global level. The most notable of those agreements have been negotiated under the auspices of the General Agreement on Tariffs and Trade and later the World Trade Organization (WTO). Those agreements may contain general provisions on trade promotion and facilitation of trade in goods (e.g. a most-favoured-nation clause, prohibition of the use of quantitative restrictions and other discriminatory trade barriers) and on the promotion of fair trade practices (e.g. prohibition of dumping and limitations on the use of subsidies). Some specific agreements are aimed at the removal of barriers for the provision of services by foreigners in the contracting States or promoting transparency and eliminating discrimination of suppliers in public procurement. Those agreements may be

relevant for national legislation on privately financed infrastructure projects that contemplates restrictions on the participation of foreign companies in infrastructure projects or establishes preferences for national entities or for the procurement of supplies on the local market.

3. International agreements on specific industries

62. In the context of the negotiations on basic telecommunications concluded as part of the General Agreement on Trade in Services (GATS), a number of States members of WTO representing most of the world market for telecommunication services have made specific commitments to facilitate trade in telecommunication services. It should be noted that all WTO member States (even those which have not made specific telecommunication commitments) are bound by the general GATS rules on services, including specific requirements dealing with most-favoured-nation treatment, transparency, regulation, monopolies and business practices. The WTO telecommunication agreement adds sector- and country-specific commitments to the overall GATS agreement. Typical commitments cover the opening of various segments of the market, including voice telephony, data transmission and enhanced services, to competition and foreign investment. Legislators of current or prospective WTO member States should thus ensure that the country's telecommunication laws are consistent with the GATS agreement and their specific telecommunication commitments.

63. Another important sector-specific agreement at the international level is the Energy Charter Treaty, concluded at Lisbon on 17 December 1994 and in force since 16 April 1998, which has been enacted to promote long-term cooperation in the energy field. The Treaty provides for various commercial measures such as the development of open and competitive markets for energy materials and products and the facilitation of transit and access to and transfer of energy technology. Furthermore, the Treaty aims at avoiding market distortions and barriers to economic activity in the energy sector and promotes the opening of capital markets to encourage the flow of capital in order to finance trade in materials and products. The Treaty also contains regulations about investment promotion and protection: equitable conditions for investors, monetary transfers related to investments, compensation for losses due to war, civil disturbance or other similar events and compensation for expropriation.